ST 95-34
Tax Type: SALES TAX
Issue: Separately Stating Tax/Separately Contracting For

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	Docket No.
	)	IBT No.
v.	)	NTL
	)	
TAXPAYER, Taxpayer	)	Administrative Law Judge Mary Gilhooly Japlon

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Attorney on behalf of Taxpayer; Special Assistant Attorney General Richard A. Rohner on behalf of the Illinois Department of Revenue.

SYNOPSIS: This matter comes on for hearing pursuant to the taxpayer's timely protest of Notice of Tax Liability ("NTL") No. XXXXX issued by the Department on December 22, 1992 for Retailers' Occupation Tax (hereinafter "ROT") due on sales and Use Tax due on purchases. Specifically at issue is whether the taxpayer is engaged in a retail occupation, and therefore subject to the ROT Act, or a service occupation, and therefore subject to the Service Occupation Tax (hereinafter "SOT") Act when engaging in indoor landscaping transactions. Also at issue is the question of whether the fraud penalty is applicable to any part of the tax deficiency. Testifying on behalf of the taxpayer were Witness A, Witness B and Witness C. Witnesses for the Department were Witness B and Witness D.

Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department in regard to the tax deficiency, and in favor of the taxpayer in regard to the fraud penalty.

FINDINGS OF FACT:

1. The Department's prima facie case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Correction of Returns, showing a total liability due and owing in the amounts of $87,014 for state ROT deficiencies and penalty, $4,554 for municipal ROT deficiencies and penalty and $1,136 for county ROT deficiencies and penalty and $3,304 for RTA ROT deficiencies and penalty. (Dept. Ex. No. 1; Tr. p. 10).

2. The taxable period at issue is July 1, 1988 through June 30, 1992. (Dept. Ex. No. 1).

3. The parties stipulated at hearing that the amount of unreported sales derived by the Department from a bank account analysis is one-half of the amount as originally proposed by the Department. (Tr. pp. 3-8).

4. The parties further stipulated as to the allocation of the amount of unreported sales as to amounts and categories of retail sales, exterior landscaping sales, rental and labor. (Tr. pp. 5-6).

5. Also stipulated to was the amount of taxpayer's costs of goods transferred incident to sales during the audit period. (Tr. pp. 3-4).

6. The taxpayer, TAXPAYER, is in the business of providing plant materials for indoor landscaping purposes. (Tr. pp. 13-14).

7. TAXPAYER is employed by client customers for various reasons. The services provided by the taxpayer in the form of plant selection, overall design and plant maintenance are some of the reasons the customers utilize its interior landscape services. (Tr. pp. 14-15, 17-18).

8. Depending on the facility and/or plant material involved, some plants are sold by the taxpayer to its customers, and some plants are leased to the customer. (Tr. p. 19).

9. The original invoices were altered to reflect the cost of goods sold in each sale, as well as maintenance costs in some cases. (Tr. pp.

28, 39, 45).

10. A fraud penalty was assessed in the instant case due to altered sales invoices. (Tr. pp. 26-27, 78).

11. This alteration was suggested by the taxpayer's original attorney and agent, Witness E, who presented the altered invoices to the Department, and is the basis of the fraud penalty. (Tr. pp. 51-52, 86, 108-109, 119).

12. The original invoices were tendered to the Department during the course of the audit by an employee of the taxpayer. (Tr. pp. 40, 85, 105-106).

13. Witness E presented the altered invoices to the Department and represented to the taxpayer that it was permissible and reasonable to "clarify" the invoices. (Tr. pp. 51-52, 85-86, 108-109, 119; Evidence Deposition of Witness E p. 11).

14. The altered invoices did not result in any assessed liability. (Tr. p. 37).

15. The Department treated the taxpayer as a construction contractor when the taxpayer acted as an exterior landscaper. (Tr. p. 46).

16. The Department assessed Use Tax on the taxpayer's costs when plant rentals were at issue at audit. (Tr. p. 47).

17. On the invoices as originally presented to the Department that did not pertain to exterior landscaping or rental services only a dollar amount was stated thereon. (Tr. p. 48).

18. There were transactions wherein the Department determined that the taxpayer was acting as a serviceman. These transactions were evidenced by invoices, as well as separate maintenance agreements that detailed the services to be provided by the taxpayer to its customers. (Tr. pp. 61-62, 84).

19. In the instances wherein the Department determined that the taxpayer was a retailer and assessed ROT, that determination was based upon

the description stated on the invoices. There were no separate maintenance agreements describing services to be provided by the taxpayer. (Tr. pp. 79, 84).

20. Other factors relied upon by the Department in determining that the taxpayer was acting as a retailer for the transactions at issue include the contents of a letter ruling issued to the taxpayer regarding its rentals and a detailed explanation of the interior landscaping business offered by the taxpayer's accountant to the auditor. (Tr. pp. 79, 81-83).

21. The Department assessed ROT on the dollar amount on the invoice. (Tr. p. 48).

22. The altered invoices reflected a tax amount relating to the taxpayer's cost of goods sold. (Tr. p. 48-49).

23. The Department circularized the taxpayer's business accounts in an attempt to obtain original invoices. (Tr. p. 53).

24. The invoices supplied by the taxpayer's business customers were copies of the original invoices presented to the Department for audit; i.e., there was no breakout of a tax rate or the cost of goods sold. (Tr. pp. 53-54).

25. The taxpayer paid tax on the cost price of the goods transferred incident to the sale. (Tr. pp. 59-60).

26. However, even though the taxpayer consistently computed its tax liability and paid the tax liability as a serviceman, it filled out the returns incorrectly. The taxpayer was reporting on the line on the returns corresponding to ROT. (Tr. pp. 57, 60, 79).

27. Department regulation 86 Ill. Admin. Code ch. I Section 130.450 provides that special service charges are to be included in gross receipts when retail sales are made, even if the services charges are separately stated, unless the purchaser signs an itemized invoice so as to indicate a contract evidencing the parties' intent. (Tr. pp. 60-61).

28. The altered set of invoices presented to the Department were not signed by the taxpayer's customers. (Tr. pp. 34, 60, 77).

29. However, the Department did not tax the service component of a retail sale (such as delivery), even if the taxpayer did not sign the invoice, as long as the service amount was separately stated. (Tr. pp. 61-62).

30. The fact that the altered invoices reflected the taxpayer's cost of goods sold had no bearing on the liability in cases that the Department considered to be retail sales. (Tr. pp. 65-68).

31. The alteration of the original invoices to reflect the cost of goods sold would make a difference to the assessed liability if the taxpayer were acting as a serviceman, as it claims it is. (Tr. p. 66).

32. Witness C is the president and sole stockholder of TAXPAYER. (Tr. 95).

33. Witness E, never indicated to the Department that the invoices he tendered were in fact an altered version of the original invoices. (Tr. 74; Evidence Deposition of Witness E, p. 23).

34. Witness E was authorized to act on behalf of the corporate taxpayer. (Dept. Ex. No. 2; Tr. p. 75).

35. From the standpoint of the service provided by the taxpayer when acting as an interior landscape contractor to its client/customer, there are no significant differences between sales and rental transactions. (Tr. p. 115).

CONCLUSIONS OF LAW: The Department assessed Retailers' Occupation Tax on the transfers of tangible personal property in the form of plant material stemming from its interior landscaping business. Its exterior landscaping work is not at issue; the Department treated the taxpayer as a construction contractor for those transactions. Its rental transactions are also not at issue. Only at issue are those transactions wherein

invoices reflected a transfer of tangible personal property at a price stated thereon. In fact, the only information set forth on the invoices at issue was the identification of a plant material and the price at which the customer purchased it.

The Department prepared corrected returns (admitted into evidence as Department's Group Exhibit No. 1) for Retailers' Occupation Tax liability pursuant to section 4 of the ROT Act (35 ILCS 120/1 et seq.). Said section 4 provides in pertinent part as follows:

> As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgment and information, which return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown therein.
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> Proof of such correction by the Department may be made at any hearing before the Department or in any legal proceeding by a reproduced copy ... in the name of the Department under the certificate of the Director of Revenue. ... Such certified reproduced copy ... shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax due, as shown therein.

One of the issues involved herein concerns the question of whether the taxpayer is engaged in a retail occupation or a service occupation when engaging in indoor landscaping transactions. The Department treated the taxpayer's interior landscaping business as a retail business based upon several indicia: the contents of a ruling letter issued by the Department to the taxpayer regarding its plant rentals, a detailed explanation of the interior landscaping business offered by the taxpayer's accountant and based upon the information set forth on the invoices.

The evidence elicited at the hearing indicates that the Department assessed ROT only in those transactions wherein the invoices as originally presented indicated that nothing other than a particular plant material was transferred for a specific sum of money. If the invoices indicated that service, such as delivery, had been performed, along with the transfer of

tangible personal property, the Department only assessed Retailers' Occupation Tax on the price of the goods transferred, as long as the service component of the retail sale was separately stated. This was the case even though the taxpayer's customers did not sign any of the invoices as required by Department regulation (86 Ill. Adm. Code ch. I, Section 130.450). The taxpayer, was therefore, given the "benefit of the doubt" in that the Department could have imposed ROT on the full price.

TAXPAYER argues that when it transfers tangible personal property incident to an indoor landscaping transaction it is acting as a service person and is subject to Service Occupation Tax. The taxpayer cites cases in its brief which set forth the standard to determine whether a service, rather than retail, transaction is involved. It must be noted that the auditor acknowledged that given the nature of the services provided by the taxpayer, he was at times acting as a serviceman. In those instances, the auditor did not assess ROT; she accepted that the taxpayer was acting as a serviceman in those situations wherein the invoices were accompanied by a separate maintenance agreement that detailed the service element that was the substance of the transaction. The auditor assessed ROT only in those transactions wherein the invoices indicated that only a plant material was transferred for a certain sum of money; there were no separate maintenance agreements in the transactions at issue.

The taxpayer asserts in its Reply Brief that it overcame the Department's prima facie case via testimonial evidence elicited from Witness C and Witness A. Furthermore, as the Department thereupon failed to prove its case correct by a preponderance of the evidence, the taxpayer's evidence must be accepted and a determination made that the taxpayer acts as a serviceman when engaging in indoor landscaping activities.

Once the Department has established its prima facie case by the entry

into evidence of certified copies of the corrected returns, the taxpayer has the burden of proving by competent evidence identified with books and records that the Department's assessment is not correct. (Mel-Park Drugs v. Department of Revenue, 218 Ill.App.3d 203 (1st Dist. 1991)). Testimony alone is not sufficient to overcome the Department's prima facie case; there must be documentary evidence in the form of books and records to corroborate the oral testimony. (Rentra Liquor Dealers, Inc. v. Department of Revenue, 9 Ill.App.3d 1063 (1st Dist. 1973)).

The taxpayer's perception of the strength of its evidence and its impact on the burden of proof is overestimated and incorrect. The Department's determination that the taxpayer acted as a retailer in those transactions at issue was based upon several factors, most importantly the books and records in the form of invoices, with no separate maintenance agreements. It is certainly conceivable that the taxpayer at times sold at retail various plant materials, with no separate services provided. Given the totality of the evidence elicited at the hearing, it is my determination that the Department's assessment of Retailers' Occupation Tax on the transactions at issue herein is affirmed.

The second and last issue to be resolved concerns the application of the fraud penalty to the deficiency. The Department imposed the fraud penalty pursuant to 35 ILCS 120/4. The statute provides in relevant part as follows: "... Provided, that if the incorrectness of any return or returns as determined by the Department is due to fraud, said penalty shall be 30% of the tax due."

The invoices as originally presented to the Department during the course of the audit did not set forth the cost of goods sold. At the suggestion of the taxpayer's original attorney the cost of goods sold was added to the invoices and thereupon presented to the Department. This alteration of business records is the reason the fraud penalty was

assessed.

The case of Brown Specialty Co. v. Allphin, 75 Ill.App.3d 845 (3rd Dist. 1979) adopts the common law rule that fraud must be proven by clear and convincing evidence wherein a civil fraud penalty is sought to be imposed pursuant to section 4 of the ROT Act. Federal Courts utilize this standard under the Internal Revenue Code where civil fraud is alleged.

The taxpayer asserts that Witness E assured him that it was proper and reasonable to make alterations on the original invoices because the notations merely clarified the taxpayer's consistent position that it is a serviceman. The notations did not affect the tax liability from the taxpayer's perspective as they merely set forth the cost of goods sold. As the Department did not accept the taxpayer as a serviceman for the transactions at issue, the invoice alterations did not affect the tax liability.

In determining whether the evidence clearly and convincingly indicates fraud, the quality of the evidence must be examined. It certainly appears in the case at bar that there is no evidence sufficient to clearly and convincingly point to a fraudulent intent or result. It is therefore my determination that the fraud penalty is not to be upheld, but rather, replaced by the deficiency penalty as set forth in section 4 of the ROT Act.

RECOMMENDATION: Based upon the foregoing, it is my determination that the tax deficiency set forth in the Notice of Tax Liability be revised in accordance with the stipulations agreed to by the parties. However, the fraud penalty is stricken and is to be replaced by the deficiency penalty as set forth by statute.

Administrative Law Judge